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AGENDA ITEM 14

TO: THE MEMBERS OF THE HEALTH BENEFITS COMMITTEE

I. SUBJECT: First Reading - GASB 45 Funding - Increase in Contracting Agencies' Contingency Reserve Fund Administrative Fee for Fiscal Year 2006/2007

II. PROGRAM: Actuarial Services, Investments, and Health

III. RECOMMENDATION:

The Health Benefits Committee recommend that the Board of Administration, as permitted in Gov. Code Section 22901, increase the Contracting Agencies' Contingency Reserve Fund Administrative Fee from the current .27% to 0.44% for Fiscal Year 2006/2007 only to provide CalPERS with the funding necessary to assist Contracting Agencies' compliance with Governmental Accounting Standards Board (GASB) 45.

IV. BACKGROUND:

During the November 2005 Committee meeting, the Health Benefits Committee (HBC) directed staff to seek funding options for workload involved in assisting Contracting Agencies meet their obligations under GASB 45. The Committee also approved the concept of a phased implementation.

In January 2006, CalPERS staff identified, documented, and estimated funding necessary for a three phased approach as outlined in the analysis section of this agenda item. Once the funding was estimated, staff submitted a Spring Finance Letter (SFL) to the Department of Finance (DOF) for \$2.9M requesting expenditure authorization from the Contingency Reserve Fund (CRF). To provide funding for the actions identified below, staff is recommending a one-time increase of .17% to the Contracting Agencies' CRF administrative fee for fiscal year 2006/2007. This would result in an overall fee of 0.44% for fiscal year 2006/2007 for the Contracting Agencies. Currently, the proposed fee for fiscal year 2006/2007 is 0.27% for both

State and the Contracting Agencies. DOF approved a Budget Change Proposal from the State Controller's Office for the necessary funding for the State of California to comply with GASB 45; so there is no need to increase the State CRF administrative fee. Historically, CalPERS has not charged different CRF administrative fees for State and Contracting Agencies. It is anticipated that the CRF administrative fee would return to being equal for State and Contracting Agencies in fiscal year 2007/2008 since this request is a one-time increase.

The Department of Finance approved our Spring Finance Letter in March 2006. Final authorization of the spending authority is expected in the Budget Act of 2006/2007. The spending authority and the recommended CalPERS Board action will allow CalPERS to proceed forward with the five activities as follows:

- ✓ Ability to provide Contracting Agencies the data needed to perform Other Post-Employment Benefits (OPEB) actuarial valuations (Phase I)
- ✓ Ability to act as a "Pass-thru" for Contracting Agencies and contractual actuarial firms that can all provide the OPEB valuations (Phase II)
- ✓ Develop a "standard" healthcare actuarial assumption model (Phase II)
- ✓ Develop a method for accepting and investing pre-funding monies (Phase II)
- ✓ Perform a detailed requirements analysis and cost study to determine the necessary requirements to implement a complete GASB Pre-funding Health Benefits Program (Phase III)

It is important to note that CalPERS currently has contracts with three actuarial firms to provide actuarial services on an as needed basis. Those three firms are Ed Friend, Inc. (EFI); Gabriel, Roeder, Smith & Co. (GRS); and Milliman Inc. All three firms have stated they are ready and able to provide actuarial services for Contracting Agencies as part of the "Pass-thru" concept.

The timeframes for the respective phases are identified below.

V. ANALYSIS:

CalPERS staff recommends a three phased approach to assist Contracting Agencies in becoming compliant with GASB 45. The three phases are detailed as follows:

Phase I – Data Extract to Perform Healthcare Actuarial Valuations

CalPERS will provide the Contracting Agencies the participant and beneficiary data needed for an accurate OPEB actuarial valuation. This will assist the Contracting Agencies and the actuarial firms providing the valuation services. These data elements will not violate the Health Insurance Portability and Accountability Act (HIPAA) privacy protections. After identifying the necessary data elements it was determined CalPERS houses the majority of those data elements in three of our

systems (COMET-Corporate Database, Retirement Information Benefit System, and the Contribution Reporting System).

CalPERS staff recommends creating a data extract of these data elements on a per employer basis. For example, if the County of Riverside would like to obtain an OPEB actuarial valuation to determine their liability, from Actuarial Firm XYZ, they will contact CalPERS and we can extract the data necessary and send the data to the County of Riverside. The same process would take place if the County of Riverside chooses to use one of the three actuarial firms on contract with CalPERS with the county paying for the actuarial services received.

If the CalPERS Board approves moving forward with the "Data Extract" we could have this available to Contracting Agencies by August 2006.

Phase II – OPEB Actuarial Valuation Agreements, Assumption Model, and Pre-funding Tracking Mechanism

OPEB Actuarial Valuation Agreements – Staff will establish the necessary contractual language with EFI, GRS and Milliman assuring CalPERS that a standard assumption model and uniform set of fees would be utilized by all three firms.

Assumption Model – Currently CalPERS does not have a healthcare actuary on staff. Therefore, staff recommends CalPERS pension actuaries partner with EFI, GRS and Milliman in identifying and documenting an appropriate healthcare assumption model. This assumption model is to be used by all Contracting Agencies that choose to utilize CalPERS as a pass-thru for their OPEB actuarial valuation and those who choose to pre-fund their GASB obligations through CalPERS.

If the CalPERS Board approves moving forward with the agreements and standard assumption model we anticipate having this completed by October 1, 2006. It is important that a standard assumption model be used by all Contracting Agencies wishing to pre-fund through CalPERS. Under GASB 43, CalPERS is required to report the unfunded liability of retiree health benefits for those Contracting Agencies pre-funding through CalPERS.

Pre-funding Tracking Mechanism - Although CalPERS staff have the ability to create a mechanism for accepting pre-funding health benefit monies, there are several outstanding issues/questions that require further analysis and research before we recommend moving forward with this option. Some of those issues/questions are listed below.

- ✓ Can CalPERS commingle the pre-funding health benefit monies with the existing Public Employees' Retirement Fund (PERF)?

- ✓ How will CalPERS handle investment monies when a Contracting Agency decides to terminate?
- ✓ How will CalPERS handle situations when a Contracting Agency decides to utilize some of their pre-funding monies?
- ✓ Does CalPERS have appropriate staffing to handle the additional workload?
- ✓ Does the current law support CalPERS accepting pre-funding monies?
- ✓ What steps are required for CalPERS to begin using the Annuitants' Health Care Coverage Fund (AHCCF) that was established in 1988?
- ✓ If CalPERS does start to receive employer contributions to pre-fund retiree healthcare, what are the total implications to CalPERS?

Analysis and research is currently underway on these and similar issues and questions. Upon completion of the analysis and research an appropriate implementation date can be identified. Staff anticipates reporting back to the Committee by the June 2006 Health Benefits Committee meeting.

Phase III – Detailed Business Case

CalPERS staff recommends a detailed requirements and cost study be performed to assist the CalPERS Board in the decision of whether CalPERS should create a new program for pre-funding retiree health benefits. The study will perform the items identified below. Staff will leverage their pension expertise to assist in the study.

- ✓ Perform best practices
 - Other pension systems have decided to move forward with pre-funding health benefits
- ✓ Identify, develop, and document business and technical requirements for the Investment Component, Actuarial Component, and Pre-funding Program
 - Includes evaluation of current systems and estimated costs
- ✓ Documentation of to-be process models
- ✓ Determination of staff allocation for all areas (Investments, Actuarial, and Pre-funding Program)
- ✓ Recommendation of organizational structure
- ✓ Perform gap analysis
- ✓ Evaluate a pre-funding system to handle enrollment data, contract information, detailed plan provisions, and collection/payment capabilities

The Business Case shall be completed by the end of fiscal year 2006/2007. Once the Business Case has been completed CalPERS staff will prepare a recommendation to the Board of Administration.

In summary, staff believes the appropriate path forward on this important issue is as follows.

- Complete the programming needs to extract participant and beneficiary data from the CalPERS system to assist employers who contract with outside actuaries to perform OPEB valuations.
- Develop the legal contracts necessary to have employers utilize CalPERS contracting actuarial firms (EFI, GRS, Milliman) to do OPEB actuarial valuations. This includes the setting of uniform actuarial fees to be charged by the outside firms and uniform actuarial assumptions to be used by the outside firms.
- Determine the requirements to accept and track contributions by employers toward their GASB 45 obligations. This includes the setting of a timeline to initiate the acceptance of such funds.
- Develop a total cost analysis and feasibility study to develop the ability of CalPERS to do all GASB 45 related work in-house including actuarial valuations, investment management and IT applications.

VI. Strategic Plan

This item supports Goal I of the Strategic plan which states, “Exercise global leadership to ensure the sustainability of CalPERS’ pension and health benefit systems.”

This program will have an impact on existing core workload for the Actuarial & Employer Services Branch, Legal Office, Investment Office, Fiscal Services Division and Health Benefits Branch. This item also has future possibilities of reducing State and Contracting Agencies’ healthcare liabilities by changing retiree healthcare premiums from a “pay-as-you-go” basis to pre-funding the benefits and investing the funds.

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